DOW THEORY LETTERS INC.

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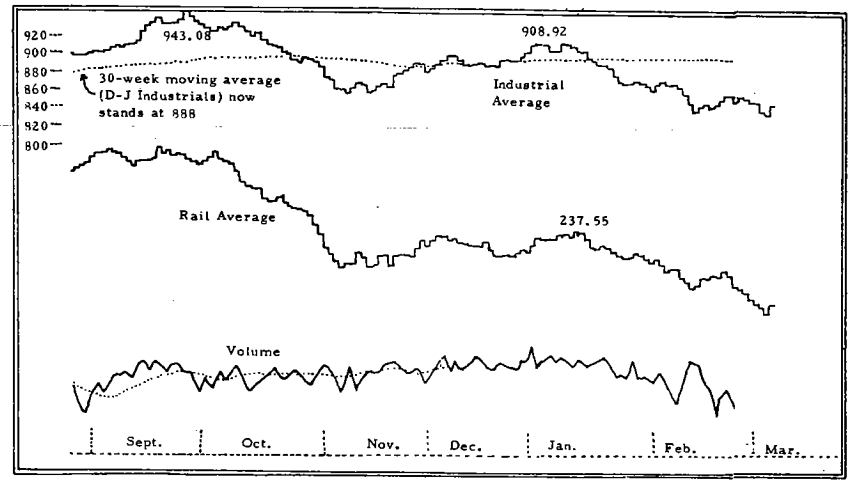
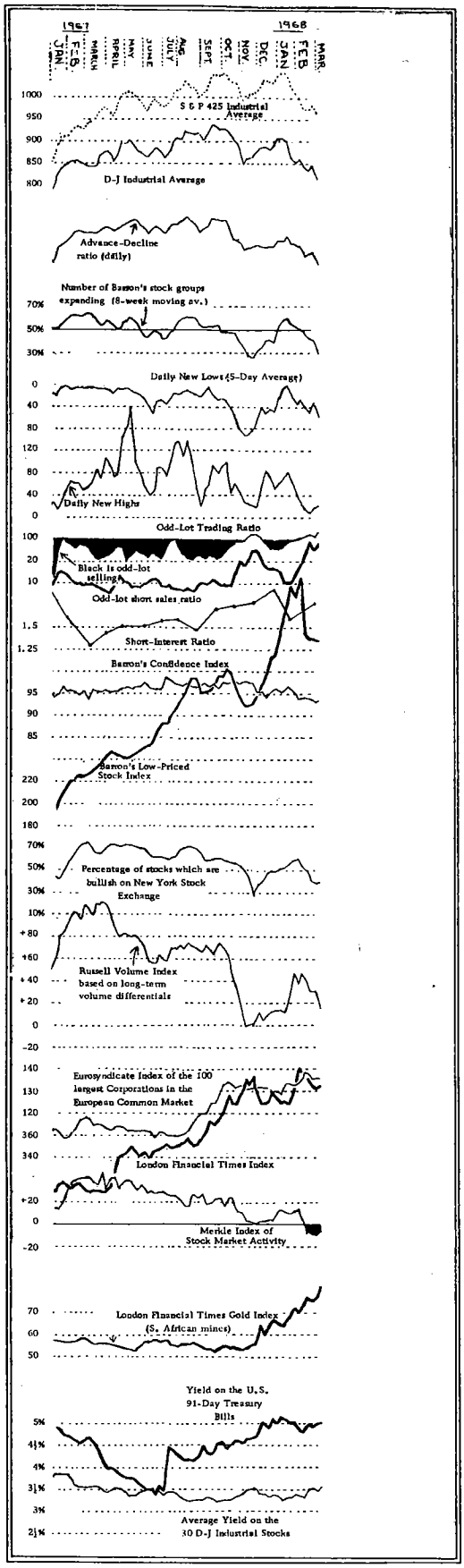
WALL STREET AND THE MARKET: The size and cost of the Vietnam war has become the nation's foremost "leading indicator." And that leading indicator is dead bearish. The Communist offensive is spreading in Asia, with the U.S. now admitting that 40, 000 North Vietnamese troops are lodged in Laos. The Communists are revolting in Cambodia, with reports of fighting in three provinces. The enemy's plan is becoming clear; stir up trouble in neighboring countries in order to take pressure off the borders of Vietnam. For through the borders run North Vietnam's vital infiltration routes to the South. Then attack the cities en masse, drawing U.S. troops out of the countryside, following which the villagers can be demoralized while the cities wait in fear of further attacks.

But the master Communist plan concerns economics, and here President Johnson has taken the bait, hook, line and sinker. In response to the Tet attack we are to increase American forces in Vietnam as quickly as possible (General Westmore land has asked for 100, 000 to 200, 000 more men). The funds for the new escalation areto be provided immediately, while "plans" for how the money is to be raised will be worked out later. The President will try to "sell" the enlarged war to the American people on the basis of national pride and honor. Wartime morale will be used in an attempt to boost the spirits of a confused and disenchanted American public.

Meanwhile, as the "unfinanced" war mounts in intensity, the pressure on the economy is increasing. Rumors fly around the financial centers of the world regarding the dollar's increasingly precarious position. The rumors become undistinguishable from the facts as confusion reigns: gold is leaving the country in huge quantities, the Government will not announce the February gold losses until Congress removes the gold cover from U.S. currency, there is to be a weekend devaluation announcement, Mills has changed his mind about the surtax.

But one fact stands out, and it is a frightening one. The coming U.S. deficit is to be gigantic. Above and beyond the admitted $5 billion supplemental, it is estimated that additional war costs are slated to have the Treasury scurrying for another $15 to $20 billion! The strain is nearing the breaking point, and the stock market is reflecting it. The main mass of listed and unlisted shares is creaking lower, some stocks giving ground grudgingly, others plunging. On




1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's stock groups expanding (8-week moving av.)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-lot short sales ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index based on long-term volume differentials
Eurosyndicate Index of the 100 largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Financial Times Gold Index (S. African mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

the other hand, gold shares have surged to historic highs as speculators and investors seek to protect themselves against a Government which seems unable to reason, to plan or to finance its expenses.

The stock market nervously notices that President Johnson has now altered his "official" language regarding the war. And while the military announces censorship over war news, the President uses such words as "blood, sweat and tears." Wall Street wonders whether an actual declaration of war may not be forthcoming. It wonders how long it will be before price and wage controls are imposed. If past history repeats, it is possible that the current stock market decline will end with the announcement of controls or some other such shocking news. Perhaps the end of the slide will coincide with an embargo on U.S. gold, a devaluation of the Canadian dollar or the French franc, or news of a general U.S. mobilization.

In the final analysis, it is fascinating but fruitless to speculate about what event or chain of events will set the bear market in motion or end a decline. As I have stated many times before, the primary trend may be held back or restrained temporarily, but in the end it will always express itself— in its own time and in its own way.

One factor is worth noting, however. In past history, when the primary trend was interrupted by a severe counter-primary force, the ultimate resumption of the primary movement was usually more intense and of greater duration than might otherwise have been the case.

Thus, for instance, when the great "Sputnik"-triggered reaction of 1957 occurred against the primary bull trend, the market was cleansed and rendered technically more potent than ever. As a result, the ensuing rise of 1958-59 was one of the most powerful in history.

Referring to the current bear market, the primary bear trend which began in February, 1966, was interrupted during late-1966 and much of 1967 by what was probably the greatest speculative spree in Wall Street annals. And remember, this amazing speculation occurred within the framework of a bear market. The upward explosion terminated on September 25, 1967, at 943.08 on the Dow. Now it seems increasingly clear that the bear forces are reasserting themselves. The speculation is ebbing, the volume is dying down.

AS TIME GOES BY (Up-dated from Letter 367): "There are some definitely encouraging elements. The ratio of casualties between Government and Viet Cong forces, the ratio of arms captured, ... the steady extension of the strategic-hamlet program, ...all those indicate some turning in the situation." —Dean Rusk, February 1, 1963.

"The momentum of the Communist drive has been stopped." —Dean Rusk, February 13, 1963.

"The South Vietnamese themselves are fighting their own battle, fighting well." —Dean Rusk, April 18, 1963.

"There is a good basis for encouragement. The Vietnamese are on their way to success and needed our help." —Dean Rusk, April 22, 1963.

"Secretary McNamara and General Taylor reported their judgment that the major part of the US military task can be completed by the end of 1965, although there may be a continuing requirement for a limited number of US training personnel." —White House statement, October 2, 1963.

"We believe that the present (Saigon) regime has moved promptly to consolidated public effort, and that the people of that country will move in greater unity on behalf of the total effort." —Dean Rusk, November 8, 1963.

"I think that resources and capabilities are there to get this job done on the present basis of assistance to the Vietnamese so that they themselves can handle this problem primarily with their own effort." Dean Rusk, February 24, 1964.

"I think they (the Viet Cong) have very serious problems— not only in fact, in terms of losses, disruptions, but in terms of morale. So I am not pessimistic about the situation." —Dean Rusk, July 1, 1964.

".....Small numbers of the US personnel will be able to return by the end of this year." — Robert McNamara, November 19, 1963.

"I am hopeful we can bring back additional numbers of men. I say this because I personally believe this is a war the Vietnamese must fight....I don't believe we can take on that combat task for them." Robert McNamara, February 3, 1964.

"I think on balance the number (US training personnel needed in Vietnam) is not likely to increase substantially." —Robert McNamara, May 14, 1964.

"The most vital impression I'm bringing back (from Vietnam) is that we've stopped losing the war." Robert McNamara, November 30, 1965.

"We are beginning to see some signs of success of this strategy.....The number of defections this year has doubled compared to the past year. No doubt this is a sign of erosion of morale." —Dean Rusk, August 25, 1966.

"I do believe that one basis for optimism is that the other side must surely now understand that they are not going to succeed in seizing South Vietnam by force." —Dean Rusk, January 1, 1967.

"I think we have seen some very favorable signs that we are making headway on the military side.... I must say that I have been impressed by the doubling of the rate of defectors from the other side." Dean Rusk, April 16, 1967.

"During the past year tremendous progress has been made.....The enemy has not won a single, significant victory during the past year, despite the tremendous effort that he has put forth." —General Westmoreland, July 13, 1967.

"Suffice it for me to say that we are generally pleased with the progress we have made militarily. We are very sure that we are on the right track." —President Johnson, July 13, 1967

"The other side is hurting, and they are hurting very badly." —Dean Rusk, July 19, 1967.

"This (Tet) offensive has required us to react and modify our plans in order to take advantage of the opportunity to inflict heavy damages upon the enemy. Although the enemy has achieved some temporary psychological advantage, he suffered a military defeat." —Gen. Westmoreland, February 25, 1968.

"There is a long road ahead. There will be blood, sweat and tears shed. The weak will drop from the lines, their feet sore and their voices loud." —President Johnson, February 27, 1968

All of which causes me to wonder what is fated for the market in the period ahead. With the flagrant counter-primary trend speculation, with a top built on a pyramid of record volume, this observer is prepared to expect almost anything over coming months.

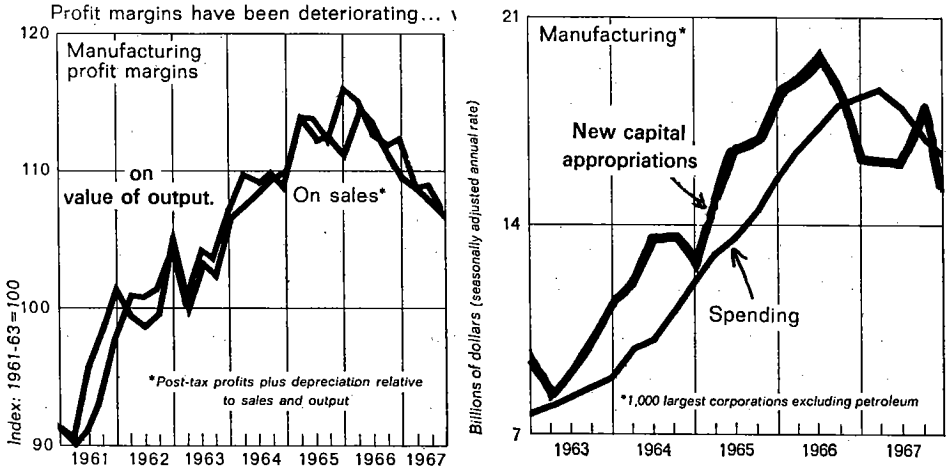
But the best and safest policy is to avoid preconceived notions regarding "support points," "selling climaxes," duration or extent of the downmove. Our position all during this bear market has been to hold cash (i.e., 91-day U.S. Treasury bills) plus 10% to 20% of our assets in assorted gold shares. Therefore, from the standpoint of my subscribers, where the market goes on the downside is rather academic (or whether it rallies is academic). We intend to stay out of this bear market until it enters its third and final low-volume, non-speculative phase.

Then, with stocks wallowing in the doldrums, with good blue-chips and growth stocks going begging for want of buyers, we will be ready to accumulate for the next major bull market. This is the procedure which should make many fortunes for readers over the years ahead. But to follow it requires infinite patience, courage, will and downright stubborness on our part. It will not be easy. It never is.

It has been asked how low I think this bear market could carry. Any guess on my part would be a bit foolhardy, but here goes. Most bear markets in past history result in a loss of half or more of the preceding bull market's gains. Since the bull market of 1949-66 (161.60 to 995.15) gained a total of 833 points, a loss of half of this amount would take the Dow back to the 577 area.

But because of the fantastic speculation which accompanied the bull market top and the unbelievable speculation which accompanied the 1966-67 secondary upward reaction, I believe this bear market could carry unusually far on the downside (the greater the speculation, the greater the need to erase the excesses). Thus it would not surprise me to see this bear market dip to the 300-500 level before it is over. This would occur during the third, low-volume phase, and this final phase action would probably occur during 1969-71.

BUSINESS AND THE BEAR MARKET: In the last Letter I wrote of the deterioration in business. This seems to have aroused some surprise on the part of subscribers, since it hardly jibes with what they read in their local papers and Department of Commerce handouts. This week Fortune magazine arrived, and their "Business Roundup" section provides two charts which I consider extremely important. I include them in this section.



The first chart deals with what economist Elliot Janeway terms "The most bearish single factor on the business horizon—the pullback from new commitments....." The chart shows that new appropriations for manufacturers' plant and equipment fell last quarter to the lowest level in over two years. The new turndown in appropriations reverses a summer uptrend which was probably brought on by the June restoration of the investment tax credit. Backing the Fortune study is the latest statistic on machine tools (see Wall Street Journal, Feb. 26). The Journal states that machine tool orders (reflecting the psychology of manufacturers) dropped in January to the lowest level in four years.

Why have appropriations dropped and why are machine tool orders collapsing, particularly in the face of the Vietnam war? The answer may be provided by a second Fortune chart. Here we see that there has been a persistent squeeze on industrial profits. The fact is that manufacturing profit margins (whether figured on sales or on value of output) have been declining since early 1966. That decline is still going on. Nothing will make a manufacturer more conservative than declining profits. When profits decline, a businessman gets edgy and thinks twice or three times about a new plant or new division. That in a nutshell, is what is occurring.

Why are profit margins declining? The causes are a leveling in sales volume, a viciously competitive market which makes price hikes extremely difficult, and rising wages and costs.

I present the above as a sort of sophisticated lesson in bear market economics. These facts have not yet appeared in the popular magazines. They are not likely to appear until they become more generally apparent. But I consider them all part of the gathering bear market picture, and I want my subscribers to comprehend fully these critical facts about the economy.

GOLD: The gold rumors are flying and you can take your choice or reject them all. Here are a few of the rumors that have come to my attention. (1) South Africa is to shut off all gold sales to the Bank of England and sell all her gold to Paris at a higher price or a free market price. (2) The U.S. will embargo gold on or around April 1. (3) France will devalue, thus forcing the British to devalue again. (4) President Johnson is ready to throw the sponge in and announce a hike in the price of gold.

All of these are rumors but three facts which caught my attention last week were (1) the British pound and the pound futures broke to a new 1967 low. (2) The International Monetary Fund reported that the five nations participating with the U.S. in the Gold Pool (which seeks to stabilize the price of gold) lost a total of $284 million in gold during January. Switzerland lost $111 million, West Germany $88 million, Italy $36 million, the Netherlands $29 million and Belgium $20 million. In the face of these losses, one wonders how much longer these nations are going to be willing to participate with the U.S. in holding gold at $35 per ounce. (3) A new gold buying rush began on February 29 with gold bullion sales rising to the highest level in six weeks. It is therefore

 rather obvious that the Gold Pool will show continuing losses for February and March.

* * * *

The March 4 Wall Street Journal carries a front page story on gold. Pros and cons of a gold price rise are discussed at length. One of the most interesting comments is to the effect that gold is now cheap compared to other metals. The result is that industrial uses of gold are now booming, and industrial users are now taking a huge percentage of all newly mined gold. Case in point, one of I.B.M.'s big new computers now carries 35,000 gold-plated circuits.

* * * *

On March 5 the Journal carried another article which discussed the current very high price/earning ratios on the Canadian golds and Homestake. The article suggested South African gold as being more reasonable in price. In response, the Canadian golds (with a correction of their recent violent rises long overdue) sold off for their first decline in 7 trading days. What the article did not state is that if the price of gold is raised, many gold mining companies will open new mining resources which have not so far been profitable to work at the present $35 per ounce price of gold. Finally, of note this week, is the S. African gold index (see page 1 chart) which rose to 82.5, highest price in 7 years.

NOTES AND QUOTES: The Weekly Bond Buyer (Feb. 19) in an article entitled "Is The U.S. Losing An Empire?" notes that America's trade surplus (measured on actual commercial trade alone, while subtracting foreign aid give-aways) was only $500 million this year. Expert projections, they state, indicate that the commercial trade surplus next year may be a deficit of $900 million. This would point to a drastic deterioration of our trade position in the world—and a dangerous deterioration at that.

* * * *

This interesting comment comes from U.S. News & World Report, (Mar. 4): "But, if Congressmen are taking the pulse correctly, the voters are dead set against any tax boost. People just throw up their hands—they do not want any more taxes, period," says Republican Senator Len B. Jordan, just back from Idaho.

In Texas, Republican Representative George Bush discovered this: "The fact that LBJ says federal taxes are lower than five years ago doesn't impress anyone. State and local taxes have risen, and people know that a bigger slice of their pay has been taken this year. There are very few Congressmen who feel any pressure from home to support President Johnson's proposed surcharge on income taxes. Those who do say it comes mainly from businessmen."

* * * *

Last week the Fed finally reversed its stand to a minus position on bank reserves. Inflation fears, the gold drain, the doubts about the LBJ-sponsored surtax being passed, all these are responsible for the Fed's new position. Business borrowing is easing and bond offerings are declining, thereby easing money rates. But the Fed is probably most worried about the gold drain. And one of the factors which worries the Fed is that short-term interest rates (due to slackening business) may decline, resulting in foreign dollars leaving for more attractive rates elsewhere. Contracting bank reserves tend to make money tighter, thereby forcing up interest rates. As seen on the composite page one chart (bottom of chart), last week the 91-day Treasury bills, the bellwethers of the short-term money market, climbed above 5% yields again.

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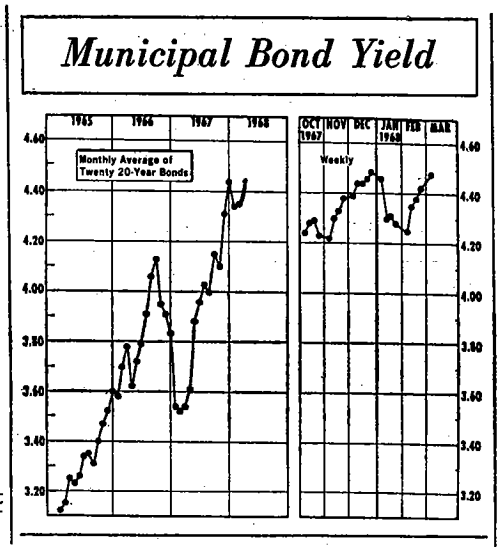


Last week the first major bond index pushed to a new high yield, perhaps signalling the beginning of a new money "crunch." Note on this WSJ chart that the Municipal Bond Index yield hit 4.48% on March 1, a mere fraction below the Jan. 2 peak of 4.49%. With Municipals weaker this week, the Index probably went to a new yield high. If so, it would mean that Municipals are now yielding the highest returns since February, 1934. In view of the correction in common stock yields, the new push in bonds yields is ominous. It means that inverse yield spread (in favor of bonds over stocks) is not being corrected, despite the decline in common stocks.

* * * *

This fascinating quote is from Joe Granville's latest report: "This ball of wax is rolling faster every week, and the days of $35 per ounce gold are surely numbered. All the gold mined in recorded history is estimated to be between $80 and $85 billion and most of this was mined in the last century. We are deeply involved in a war costing us $30 billion a year. Imagine, three years of this kind of war costing more than the equivalent of all the gold mind in history. This type of pressure alone is enough to push us into devaluation and it has already been estimated that our gold stock will be down to the psychologically critical level of $10 billion by August or sooner. When our gold stock threatens to drop under $10 billion it is believed that the pressure for raising the price of gold will reach irresistable levels."

The following is part of an article which treats the current "stock market course" craze with reverence and enthusiasm. But I happen to view it with some trepidation. I call it mass distribution of stocks to the public.

One reason why so many new investors are taking the plunge these days is that virtually every brokerage firm is offering free courses in the mysteries of the market. The New York Stock Exchange, which prepares lessons and teaching aids for member firms, has helped organize 780 lectures drawing 33,690 people in the New York City area during the past six months. "It's almost mass-production sales promotion," says Reynolds & Co. Partner Alpheus Beane. His firm offers three different levels of courses to groups gathered anywhere from Y.M.C.A.s to shopping centers, and it is now sponsoring its second series on investments for National Education Television.

Brokers have been offering market courses for years, but the number and variety are burgeoning. For the teaching broker, the rewards can be considerable. Firms have found that 35% to 40% of their students sign up for accounts. In Cincinnati, Thomas Shuff of Hayden, Stone Inc., has started an eight-week, non-credit course on investments at the city university. Last week, at the first session, he was pleasantly surprised to find his classroom packed with 200

From Time magazine, March 1, 1968

Gold Embargo Rumor Boosts Bullion Trade

Compiled from
The San Diego Union's News Services

NEW YORK — Demand for gold picked up sharply here and in Paris yesterday but prices generally were firm.

Bullion dealers attributed the renewed demand to increasing apprehension about world currencies and rumors that the United States would stop selling gold April 1 and apply to the International Monetary Fund for a $10 billion loan.

The price for gold was fixed in London at $35.19⅞, up ⅛ cent from Wednesday. Demand was fully met at that price by the International Gold Pool, operated by the Bank of England.

Dealers said demand came from several Continental centers, with orders from Geneva and Paris particularly prominent. Activity was reported to be the heaviest in six weeks but nowhere near the levels of the pre-Christmas gold rush last year.

After European markets closed, the International Monetary Fund reported the gold reserves of five European nations participating with the United States and Britain in the gold pool declined $284 million in January.

The biggest loss was $111 million by Switzerland. West Ger-

Pound Rate Rises; Gold Rush Still On

LONDON (AP) — The British pound bounced back from an all-time low yesterday, but Europe's gold rush kept the dollar under attack.

The gold buyers were gambling the United States will be forced to raise the price of gold and thus hand them a handsome profit. That in effect would be a devaluation of the dollar.

London's foreign exchange market opened with the pound at $2.3975, 33 points down from Monday's closing and the lowest value for sterling in history. The official rate set when it was devalued on Nov. 18 was $2.40.

The Bank of England did some judicious support buying and the rate rose to $2.3985.

Then the bank moved out of the market and watched the pound reach its own level.

JUMPS UP

The speculators were soon running for cover and the pound jumped up to $2.4025.

Demand for gold remained high all day in the London, Zurich and Paris bullion markets.

The sterling price of gold reached an all-time high of 293 shillings 6¼ pence at the London fixing, but the dollar parity remained just under the ceiling of $35.19⅞. In Paris, though, where the rate is allowed to float above the ceiling, the price reached $35.29.

Sales in London were believed to have been in the 40 to 50-ton range, still far below December's crisis level of more than 100 tons a day. In Paris about three tons changed hands.

An outcry, meanwhile, rose over the speculative attacks on the dollar which observers saw as threatening the very foundations of the entire international monetary system.

The Times of London charged that some governments, "activated by political malice toward the United States," are behind the gold rush.

INTOLERABLE SITUATION

The newspaper did not name the governments but said it was no "secret that a number of important governments would dearly love to see the dollar devalued."

"It is intolerable that the whole future stability of the world's trading and monetary systems should be at the mercy of every passing rumor that assails international foreign exchange and gold markets," it said.

Financial experts noted that the Canadian dollar and the Japanese yen also have been under heavy pressure lately. There even have been reports, strongly denied in Paris, that French President Charles de Gaulle might devalue the French franc.

HEADLINES OF THE DAY: I thought a few of the dramatic stories which appeared last week were worth putting together on one page. Here we see the story of the new gold rush, the smash of the pound to an all time low, and the worried U. S. Federal Reserve Board tightening reserves as the dollar comes under attack. Save this page for your grandchildren. It's economic history— in its most dramatic form.

TIGHTENING SEEN IN CREDIT POLICY

Major Financial Indicators Show a Trend Toward Monetary Restraint

U.S. NOTE SALE CITED

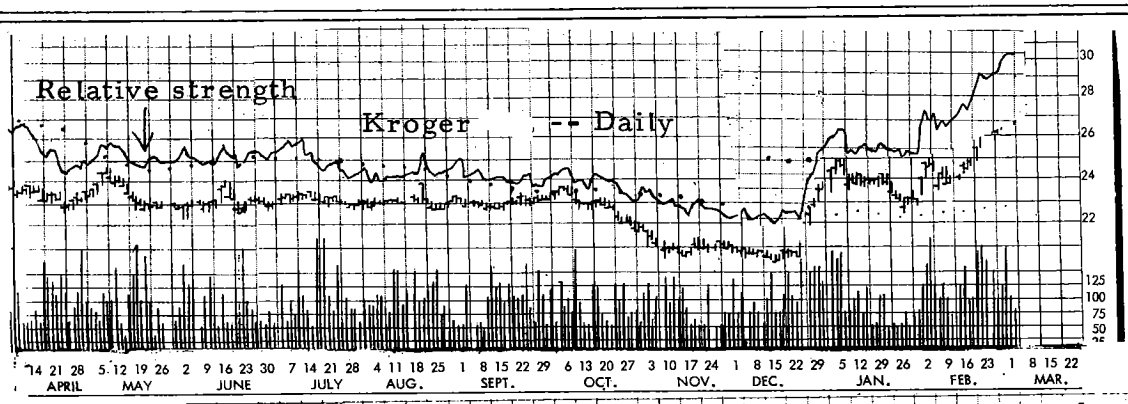
'Dead Give-Away' Sighted in Bank Borrowing From the Reserve System

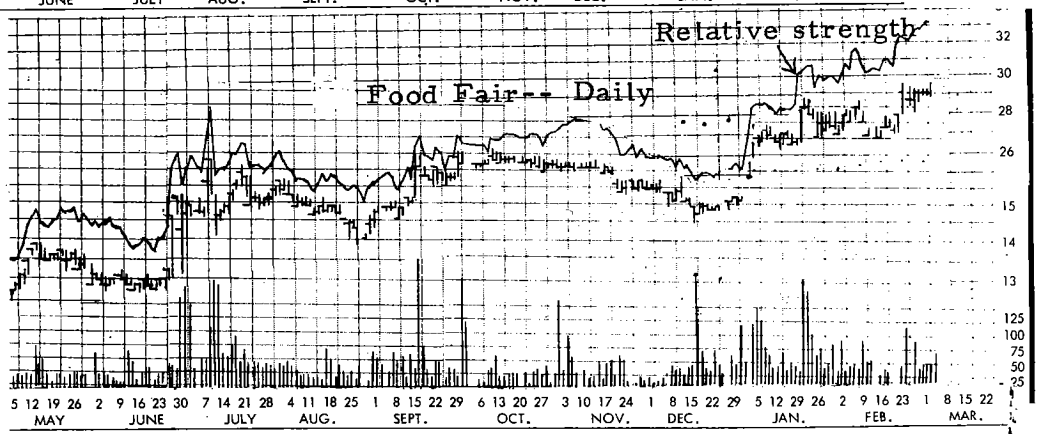
By H. ERICH HEINEMANN

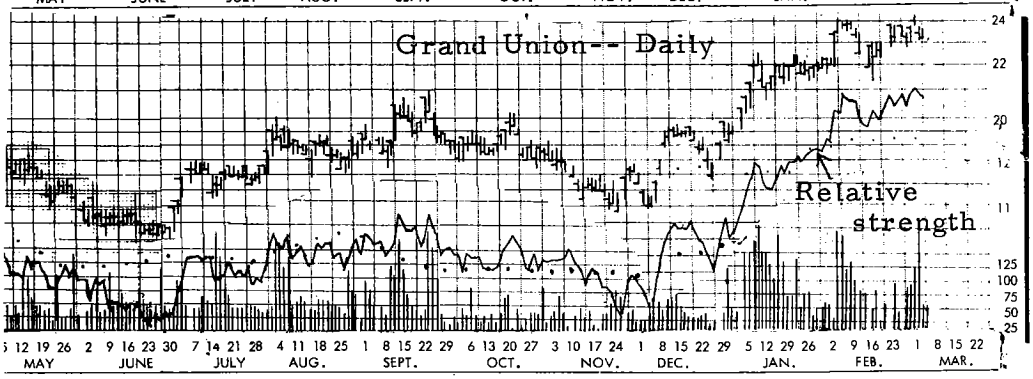
The Federal Reserve moved decisively toward tighter credit in the week ended Wednesday, according to banking statistics released yesterday.

The principal indicators of monetary policy—the net reserve position of the nation's banks, total reserves and the money supply — all showed signs of the developing trend toward monetary restraint.

DOW THEORY MARKET LABORATORY PAGE







As the bear market progresses, investment money and fund money must seek a safer haven for its capital. In the last Letter I discussed a few bank stocks. The banks are classic defensive vehicles for "scared" money. As the mass of stocks sink lower, money has been switching out of the glamors and the high-flyers and into the banks.

A second place where money ear marked for common stocks is going (or switching) is the grocery chains. In the broadest sense, the theory here is that the world can fall apart but people have to eat. This is a rather unsophisticated approach, since in a bear market the profit margins of grocery chains can suffer along with everybody else's profit margins and secondly, people can and will eat less (and they will buy cheaper foods). But there is no doubt that many of the food chains, following a few years of vicious competition and rising costs, have begun turnarounds.

The trend in food chains is towards cost control, dumping of trading stamps, and writing off of high expenses brought on by an explosion of new stores. In many cases, sinking profits have been stabilized and are now heading higher. The market for food chain shares is reflecting all of this and I include charts of three important chains.

Note the long, dragging, accumulative action in these stocks. Important bottoms appear to have been struck by all three stocks around November, 1967, following which the shares have moved higher. Relative strength (or the action of the stocks compared with the general market) has improved importantly, and it is obvious that money is now coming into the food chains in an important manner.

I cannot recommend purchase of these shares during this bear market, but I want to call attention to significant counter-trend stock action nevertheless. I would think that the grocery chains could move substantially higher during the next major (upward) reaction in the bear market. In my opinion, the food chains will also show much less downside action during the bear market than most other groups. This, I will repeat, does not constitute a recommendation, but for those who cannot resist trading I would say that the food chains are an interesting place to put speculative money.